

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-1342

United States Court of Appeals
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

v.

DOUGLAS P. FIELDS, FREDERICK M. FRIEDMAN,
PETER S. DAVIS, ALAN E. SANDBERG, and ERIC
BERGE,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY MEMORANDUM TO THE SECURITIES AND
EXCHANGE COMMISSION'S *AMICUS CURIAE* BRIEF

BENDER & FRANKEL

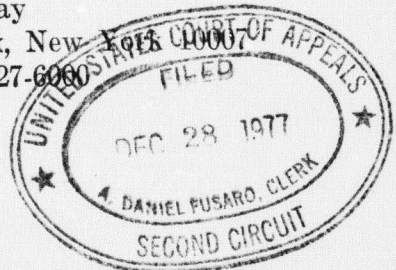
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Appellees Fields and Friedman respectfully submit this memorandum in reply to the SEC's *amicus curiae* brief, pursuant to permission granted by this Court in the letter of November 22, 1977 from the Clerk of this Court to the Solicitor to the Securities and Exchange Commission (hereinafter "SEC").

It is respectfully submitted that the SEC's brief conclusively establishes that the criminal reference pro-

cedure* followed by the SEC's attorneys in this case violated what the SEC's brief states is the SEC's established criminal reference system.

At the outset, it should be said that the SEC's brief is commendably frank in two respects: (a) it makes no attempt to defend the improper actions of those of its staff found by the District Court to have acted deceptively and improperly; and (b) it tacitly concedes that in this case the SEC's procedure for making the criminal reference, as described by the Commission in its memorandum, was violated.

The SEC's brief (at page 10 thereof), in outlining its criminal reference procedure, states:

"Where, however, a formal investigation is in progress**, and the United States Attorney, after preliminary communications, indicates his interest in pursuing the matter further, the Commission itself approves the referral of investigatory materials to the United States Attorney for possible criminal prosecution. A criminal reference may assume two principal forms (discussed immediately below) but, *in either event, it is authorized by the Commission.*" (emphasis added)

* The SEC's brief was, according to the letter from the Clerk of this Court requesting its submission, to be limited to a single issue. That issue was specifically addressed in the appellate brief filed on behalf of appellee Sandberg, the contents of which were specifically incorporated by appellees Fields and Friedman (see brief for appellees Fields and Friedman at p. 11, fn. 9 thereof). Accordingly, the within memorandum submitted on behalf of Fields and Friedman will be limited to that issue.

** In the instant case, the "formal investigation" was commenced, pursuant to a formal order of the Commission in February, 1975 (T. 811). The letter "T" followed by a number designates a page reference in the Transcript of the Proceedings below filed in this Court.

The SEC's brief acknowledges (at page 11) that even where referrals must be made on an expedited basis in order "to save time", the criminal reference process still involves "review by the Director of the Commission's Division of Enforcement and the Commission's General Counsel, who submit the matter to the Commission for its consideration." The SEC's brief, while acknowledging that any such reference requires authorization by the Commission itself, inexplicably fails to address the issue of whether that admitted procedural requirement was followed in this case. In fact, it was not. On the final day of testimony at the hearing below, there were introduced into evidence the following two exhibits:

- (a) A "minute" of a meeting of the SEC held on April 25, 1977 (A 174) reflecting that on that date the SEC authorized the referral of its files on this case to the United States Attorney's Office—some nineteen months after the "informal" referral by Perlmutter to Sorkin, sixteen months after the "informal" referral by Tucker to Wing, six months after the indictment in this case was filed, and after the hearing on appellees' motion to dismiss in the Court below had begun;
- (b) An internal memorandum of the SEC, also dated April 25, 1977, reflecting approval by the SEC, acting through three Commissioners, of the transmittal by the SEC of its investigatory files to the United States Attorney's Office (A 294). This memorandum states as follows:

"Reason matter was not promptly forwarded to Commission for regular calendar action: [the space provided for an answer is left blank]"

"Reason matter cannot await Commission action under normal schedule: There is an evidentiary

hearing in this case scheduled for today. The indictment has already been obtained and the case has not been formally referred."

Thus, it is clear that the SEC's procedure as set forth in its *amicus curiae* brief was plainly violated in this case, *as the prosecutor conceded in the Court below that the SEC files had been turned over to the United States Attorney's office prior to the Commission having authorized it* (T. 793). The SEC's brief admits, in the portion quoted above, that approval by the Commission itself is necessary before a criminal reference* may be made. Not only was that approval by the SEC not sought and not obtained at the time mandated by the SEC's own procedure, it was not obtained until long after the indictment was returned, and during the hearing on appellees' motion to dismiss

* The above-quoted statement in the SEC's brief is ambiguous; it is unclear whether Commission approval is said to be necessary before a criminal reference may be made, or before the SEC's investigatory files may be transmitted. In either case, it is clear that the procedure was violated in this case. The SEC somewhat ambiguously seems to suggest that the referrals by Perlmutter to Sorkin and Tucker to Wing were not "criminal reference" but were some different species, "preliminary communications" (see last sentence p. 11, n. 28 of SEC brief). If this is what the SEC intends to suggest in this footnote, that is completely contradictory to the concession made by the prosecutor during the first five minutes of the hearing below:

"[Mr. Cutner]: To sum up, we do not dispute in this hearing that the matter came to the attention of the U. S. Attorney's office from the New York regional office of the SEC.

The Court: And I need not concern myself with semantic subtleties as to whether or not what took place was a "criminal reference", you make no point on that?

Mr. Cutner: I do not.

The Court: Does that suit your purpose?

Mr. Bender: Yes."

in the District Court. The SEC's memorandum, unfortunately, makes no mention of this fact.

Furthermore, the statutory authority to refer cases for criminal prosecution authorizes referrals to the Attorney General of the United States, not to United States Attorneys, and certainly not to Assistant United States Attorneys. The SEC's brief states, in footnote 19, that its brief "use[s] the terms Attorney General, Department of Justice, and United States Attorney interchangeably in this memorandum." There is simply no legal authority (certainly not those cited by the SEC) for considering these institutions as interchangeable items when Congress has granted powers with respect to only one such institution, i.e., the Attorney General. Cf. *United States v. Giordano*, 416 U.S. 505, 509, 94 S.Ct. 1820, 1823 (1974).

The SEC's brief also states (at page 8 thereof) that it is the SEC's "policy" to "encourage its staff" to bring criminal cases to the attention of the United States Attorneys' Offices. With respect to this assertion:

(a) The SEC's memorandum fails to cite any legal authority by which it has established such a "policy". As the SEC's brief accurately states (at page 7):

"Congress authorized *the Commission*, in connection with each of the statutes which it administers, to refer information indicating violations of these statutes, as well as others, to the Attorney General." (emphasis added)

The "policy" of having "staff" rather than "the Commission" make such references is without legal authority, and the Commission's memorandum does not even attempt to state any such legal authority. Moreover, there appears to be no published rule or order by the SEC delegating its responsibility to

make criminal references, notwithstanding the brief's statement that such a delegation is a matter of the SEC's "policy". Indeed, the SEC's enforcement manual on criminal references makes no mention whatever of this alleged informal policy, nor does it suggest the propriety of any criminal reference except by the Commission itself (A 207, et seq.).

(b) The SEC's brief fails to state what "staff" is authorized by its "policy" to make such references. Is it the Director of the Commission's Division of Enforcement in Washington?* The administrator of a regional office such as the NYRO? A local associate regional administrator? An assistant administrator? A mere staff attorney, the lowest rung on the hierarchy of attorneys employed by the SEC, such as Perlmutter, who made the initial reference to Sorkin in this case? Could it be a secretary? Are there any internal controls to prevent references motivated by improper factors, such as a staff attorney's pique at a lawyer representing the target of an investigation? It is respectfully submitted that the SEC's memorandum, in simply asserting that its "policy" is to encourage references by its "staff", has simply failed to address the more substantial issue which was the subject of this Court's request for an *amicus curiae* brief.

(c) This "policy", which the SEC's brief now announces to this Court, flatly contradicts the SEC's

* The Director testified at the hearing below that had he been Tucker or Perlmutter, given the factual situation ultimately found by the District Court, he would have expressly stated to counsel for the defendants in the civil action that the civil settlement about to be entered into would have no impact on the possibility of a criminal reference (A 557-558).

publicly stated policy expressly stated to the United States Congress. On July 25, 1977, in a formal written response made by the SEC to a series of questions propounded by the Chairman of a Congressional subcommittee acting on behalf of the House of Representatives of the United States Congress, the SEC stated that after its investigation of a potential criminal case has been completed, its procedure in making a criminal reference is as follows:

"Upon the conclusion of this process a written report is prepared. Generally this report contains a detailed presentation of the facts supported by reference to the proof, a discussion of the theory of the case, a section of the applicability of relevant law to the facts in the context of criminal liability, an analysis of the strengths and weaknesses of the case, the witnesses and possible defenses, and a recommendation as to whom the Commission should seek indictments against.

"This report, known as a criminal reference, is thereafter reviewed at increasingly higher supervisory levels within the Commission. At each of these review levels the report and recommendation is considered by persons of increasing experience and authority who may determine whether further investigation or legal analysis is necessary, whether proposed defendants should be added or deleted, and whether further pursuit of this report should be made at all. Finally, the Commission itself, on the recommendation of its General Counsel, must approve the staff's recommendations that the report and underlying evidence be referred to the Department of Justice. After this approval the Division of Enforcement's

Branch of Criminal Reference forwards the recommendation and evidence to the Department." (A 248-9)

The Commission restated this "policy" substantially verbatim in a second response to the subcommittee (A 283-4). The SEC thus assured the Congress that there is a thorough and continuing series of reviews at various "supervisory levels", conducted seriatim "by persons of increasing experience and authority", and that ultimately the Commission itself, acting on recommendation of its general counsel, "must approve" the staff's recommendation before a criminal reference is made. Clearly, the SEC's "policy" regarding criminal references as expressed in its brief *amicus curiae* to this Court sharply conflicts with its policy as expressed to the United States Congress.

Appellees Fields and Friedman also respectfully wish to reply to two assertions made in the SEC's memorandum which stray from the limited question asked by this Court in its request for an *amicus curiae* brief.

The SEC's memorandum asserts several times (*e.g.*, p. 12) that it has a long-standing policy that is "well-known" to the securities bar of not permitting a civil settlement to affect a possible criminal reference. However, as noted in the brief originally submitted on behalf of appellees Fields and Friedman (at page 44 thereof), this "well-known" policy was neither known by nor followed by the SEC's own attorney who at the time of the civil investigation of this case was Assistant Regional Administrator of the NYRO, and who is presently Associate Regional Administrator in another of the SEC's regional offices.

The SEC's memorandum also states (at p. 12) that "in those few cases where the criminal aspects are resolved as part of the civil settlement, the Department of Justice

participates in the negotiations." That statement is refuted by the very procedure followed by the SEC in its civil investigation of the TDA case. The SEC did in fact grant what was tantamount to a practical immunity to two individuals, Messrs. Weston and Kreisler, as to whom the SEC agreed, with counsel for both of those individuals, that they would not be named in a criminal action (A 119, fn. 8). Furthermore, this statement in the SEC's brief misstates the issue in this case, which is not whether the SEC "resolves" criminal cases by granting "immunity" in connection with dispositions of civil cases, but whether the SEC's specifically bringing this case to the attention of the United States Attorney's Office under circumstances of the fraud and deception practiced upon the appellees in this case justified the District Court's dismissal of the indictment.

CONCLUSION

For the reasons set forth above, for the reasons set forth in the original brief submitted on behalf of appellees Fields and Friedman, and for the reasons stated during oral argument of this appeal, it is respectfully submitted that the District Court's Order dismissing portions of the indictment should be in all respects affirmed.

Respectfully submitted,

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